

Testimony of Mark A. Calabria, Ph.D.
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Before the
House Committee on Financial Services
On H.R. 3068, TARP for Main Street Act of 2009
July 9, 2009

Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a nonprofit, non-partisan public policy research institute located here in Washington. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official policy positions of the Cato Institute. In addition, outside of my interest as a citizen and a taxpayer, I have no direct financial interest in HR 3068, nor do I represent any entities that do.

The first point of my testimony is that despite the repayment of TARP funds from a number of banks, and the receipt so far of over \$6.2 billion in dividends from TARP institutions, the TARP overall has not been profitable. CBO's most recent estimate, released on June 17th, is that the overall subsidy cost of the TARP will be \$356 billion. To be very clear, this is \$356 billion of loss to the taxpayer that will not be recovered. I know of no creditable forecaster or auditor that is projecting profits for the TARP program.

In addition to the \$356 billion in losses from the TARP, we are also likely to see between \$200 billion and \$300 billion in absolute losses from the bailout of Fannie Mae and Freddie Mac. We may also see losses in the tens of billions from the Federal Reserve mortgage backed securities purchase program.

So we are likely to see ultimate taxpayer losses from the various bailouts approach \$700 billion. While any dividends received will make only a small dent in those losses; diverting those dividends for purposes other than off-setting TARP losses will only leave the taxpayer with a larger hole to fill.

If however, Congress chooses to use TARP dividends, or any other funds, to support the housing market, I believe Congress should focus on stimulating the demand side of the housing market, rather than the supply side. The fundamental problem facing our nation's housing markets is an oversupply, a "glut", of housing, rather than any lack of housing.

The nation's oversupply of housing is usefully and carefully documented in the Census Bureau's Housing Vacancy Survey. The Census reports a national rental vacancy rate for the first quarter of 2009 at 10.1 percent. This is only slightly below the historic record rental vacancy rate of 10.4 percent, and is almost 40 percent higher than the average vacancy rate for the last 50 years of 7.2 percent.

The record rental vacancy rates are not simply an issue of specific geographic areas, but are found almost throughout the country. In fact, the highest rental vacancy rates, and also the areas seeing the largest increases in rental vacancies are in our nation's central cities. In fact, all the increase in vacancy rates over the last year can be attributed to the increase in central city vacancies. Rental vacancies in suburban and rural areas, while still near historic highs, have moderated over the last year and remain below that of central cities. The primary importance of this fact relates to the tendency of our federal housing production programs to concentrate new housing production and rehabilitation in the central cities.

Even in parts of the country with traditionally tight rental markets, such as California, which while remaining tighter than the nation overall, have seen increases in rental vacancy rates over the last year. Since the bursting of the housing bubble in 2006, we've seen rental vacancy rates increase in California by over 10 percent. Few states, however, have witnessed the increase seen in Florida, where rental vacancy rates have jumped by over 60 percent since the bursting of the housing bubble. Of course, some states, particularly those where the housing bubble had little impact on prices, such as Ohio and Michigan, have not seen major increases in rental vacancies, but still have rates considerably higher than the national average. Interestingly, the states with the lowest vacancy rates are Vermont and Wyoming, and are concentrated in rural areas, those very areas where our federal production programs have been least effective.

Our federal production programs also tend to build almost exclusively multifamily properties, as would likely be the case with a production-focused trust fund. However, over two-thirds of vacant rental units are currently in multifamily properties. This fact is not simply the result of older units based in older urban areas. The rental vacancy rate for units constructed in the 2000s is almost twice that of units completed in the 1990s. Despite an almost 1 million increase in rental households associated with the meltdown of our mortgage markets, the number of vacant for rent units has actually increased by almost 100,000 over the last year. Since the bursting of the housing bubble, the overall number of vacant rental units has increased by over 400,000. There are currently over 4.1 million vacant units for rent in this country. In addition to this excess supply of housing, there are almost 7 million vacant units being held off the market. In all likelihood, many of these units will enter the rental market as owners look for ways to derive income from vacant homes. The glut in our housing markets is not only one of single-family units intended for homeownership, but also one of recently constructed multifamily rental units.

Recognizing that was a considerable amount of data, my basic point is that additional housing subsidies should be focused on stimulating demand. The most obvious method of doing so would be with additional rental vouchers. Additional production runs the very real risk of adding to supply, and hence putting downward pressure on home, particularly condo, prices, which could have the perverse effect of increasing mortgage defaults. Additional production could also increase multifamily mortgage defaults.

In addition to directing any additional housing subsidies only at tenant-based assistance, I also encourage Congress to examine the feasibility of re-directing current unit based subsidies, which are not already committed to a specific housing unit, toward increased vouchers. Such a move would help increase the demand for rental housing while also providing much needed assistance to the recently unemployed.

A final concern with HR 3068 is both the precedent it sets for re-directing TARP funds and its potential to erode the checks-and-balances that come with the appropriations process. Once the line has been crossed to redirect TARP dividends to non-TARP uses, I fear it will only be a matter of time before TARP repayments are also redirected. While HR 3068 represents just over \$6 billion, it could easily become the first-step in a process that results in \$100s of billions being diverted. Such would only leave the taxpayer with an even greater burden. I strongly urge any additional housing subsidies, trust fund or otherwise, to be subjected to either the appropriations process or to pay-go.

The repayment of TARP funds has raised a variety of legal questions, perhaps the most important of which is the Treasury Secretary's ability to re-allocate those funds. Pronouncements from Treasury have been mixed and at times in contradiction. I would suggest Congress examine whether the Treasury Secretary has the ability to re-allocate TARP funds once they have been repaid. In order to reduce the potential for additional losses under TARP, Congress should consider explicitly restricting the ability of the Treasury to re-spend TARP funds that have been repaid.

While the various bailouts have been truly expensive and shocking, I unfortunately do not believe all the bailouts are behind us. In particular, there is a high likelihood that tens of billions of taxpayer funds will be needed to re-build the Federal Housing Administration's single family mortgage insurance program. In order to minimize the ultimate cost of that bailout, I urge the Committee to begin examining the structure of FHA and institute much needed reforms to protect the taxpayer from unnecessary loss.

Chairman Frank, Ranking Member Bachus, members of the Committee, I again thank you for this opportunity and appreciate your attention. I welcome your questions.

Mark A. Calabria, Ph.D. is Director of Financial Regulation Studies at the Cato Institute. Before joining Cato in 2009, he spent six years as a member of the senior professional staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs. In that position, he handled issues related to housing, mortgage finance, economics, banking and insurance for Ranking Member Richard Shelby (R-AL). Prior to his service on Capitol Hill, Calabria served as Deputy Assistant Secretary for Regulatory Affairs at the U.S. Department of Housing and Urban Development, and also held a variety of positions at Harvard University's Joint Center for Housing Studies, the National Association of Home Builders and the National Association of Realtors. Calabria has also been a Research Associate with the U.S. Census Bureau's Center for Economic Studies. He has extensive experience evaluating the impacts of legislative and regulatory proposals on financial and real estate markets, with particular emphasis on how policy changes in Washington affect low and moderate income households. He holds a doctorate in economics from George Mason University. <http://www.cato.org/people/mark-calabria>